

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE:) In Proceedings
) Under Chapter 12
HAROLD AND PRISCILLA HENNESSEY)
) No. BK 89-50721
Debtor(s).)

OPINION

Following confirmation of their Chapter 12 plan, debtors Harold and Priscilla Hennessey sued their bankruptcy attorney in state court, alleging malpractice in the handling of their Chapter 12 case. While the suit was pending, debtor Harold Hennessey became terminally ill, and the debtors obtained a hardship discharge based on their inability to make payments. The debtors' case was closed, and the lawsuit was eventually settled following the death of Harold Hennessey for the sum of \$4,000.

The Chapter 12 trustee, having obtained an order reopening the debtors' case, now seeks a determination of whether any of the settlement proceeds should be distributed to creditors.¹ Counsel for debtor Priscilla Hennessey responds that the proceeds should be distributed to his client who, as a widow with two children, is in need of such funds. Counsel maintains that the small amount of settlement proceeds would not result in substantial payment to any creditor and argues that equity would support allowing Priscilla

¹In its order granting the debtors' hardship discharge, the Court specifically retained jurisdiction to "determine if any proceeds made available through litigation pending in Bond County, Illinois, and brought by the debtors against Robert T. Bruegge, Bruegge & Becker, and Paul Antonacci, should be distributed to creditors."

Hennessey to keep the funds.

The facts are not in dispute. Shortly after confirmation of the debtors' Chapter 12 plan in October 1990, the debtors requested that their bankruptcy counsel, Robert Bruegge, withdraw as their attorney. After retaining new counsel, the debtors sought and obtained modification of their confirmed plan in December 1990 regarding the claim of a secured creditor. In June 1991, the debtors again modified their plan regarding this creditor.

On January 28, 1992, the debtors filed the subject lawsuit against Bruegge and his firm. Subsequently, in December 1992, the debtors filed their motion for hardship discharge. The lawsuit was still pending in February 1993 when the Court granted the debtors' motion for hardship discharge. The trustee's final report, filed at the close of the case in April 1993, reflected that no payments had been made to unsecured creditors.²

In determining the disposition of settlement proceeds now held by the trustee, the Court must consider, first, whether the proceeds constitute property of the debtors' estate and, if so, whether the trustee is required to distribute the proceeds to unsecured creditors either pursuant to the debtors' confirmed plan or the provisions of Chapter 12. Under § 1207(a), "property of the estate" in a Chapter 12 case includes not only all the debtor's legal and equitable interests in property as of the commencement of the case as specified in §

²The trustee's report showed that a total of \$89,968.54 had been paid to two secured creditors. Unsecured claims that remained unpaid totaled approximately \$ 26,000. The debtors' confirmed plan had estimated that unsecured claims would be paid in full.

541(a), but also all property that the debtor acquires "after the commencement of the case but before the case is closed, dismissed, or converted . . . , whichever occurs first[.]" 11 U.S.C. § 1207(a).

In this case, the debtors' claim against attorney Bruegge arose from his handling of the debtors' bankruptcy case. Bruegge's representation of the debtors ended shortly after confirmation of their Chapter 12 plan, and the debtors' lawsuit was filed during the pendency of their plan over a year before the case was closed. Thus, the debtors' cause of action, which qualified as an interest in property under the broad language of § 541(a), was acquired by the debtors after the commencement of their case but before it was closed and constituted estate property under § 1207(a). Cf. In re Cook, 148 B.R. 273, 277 (Bankr. W.D. Mich. 1992) (lottery winnings acquired by Chapter 12 debtors after confirmation of their plan and during the plan period were property of the debtors, estate under § 1207(a)). Since "proceeds" of estate property likewise constitute "property of the estate," see 11 U.S.C. § 541(6), the proceeds here at issue from settlement of the debtors' lawsuit are included as property of the debtors' Chapter 12 estate.

The debtors' Chapter 12 plan, which was confirmed prior to the debtors' initiation of the lawsuit against attorney Bruegge, did not specifically provide for disposition of this property interest. With respect to unsecured creditors, the plan contained a provision pursuant to 11 U.S.C. § 1225(b)(1) that all disposable income would be distributed to unsecured creditors. The plan further provided that, upon confirmation, all property of the estate vested in the debtors

free and clear of any claim. See 11 U.S.C. § 1222(b)(10). The settlement proceeds at issue in this case do not qualify as "disposable income" to be distributed to unsecured creditors under the plan because the proceeds were not income that was "received" by the debtors "during the period of the plan." The disposable income provision of § 1225(b)(1) states that if the trustee or an unsecured creditor objects to confirmation of a plan, the plan must provide that

all of the debtor's projected disposable income
to be received in the [period of the plan] . . .
will be applied to make payments under the plan.

11 U.S.C. § 1225(b)(1) (emphasis added).³ The settlement proceeds here were received after the debtors' case was closed and not during the period of their plan. Thus, the disposable income provision of the debtors' plan does not apply to require that the trustee distribute the settlement proceeds to unsecured creditors.

In appropriate instances, a debtor's acquisition of property during pendency of a Chapter 12 case may be grounds to modify the debtor's Chapter 12 plan to afford a greater distribution to creditors. Section 1229(a) provides for postconfirmation modification to increase or reduce the amount of payments on claims of a particular class, extend or reduce the time for such payments, or alter the distribution to a class of creditors. See 11 U.S.C. § 1229(a). When the debtors in In re Cook won \$6 million in the Michigan State Lottery after

³"Disposable income" is "income which is received by the debtor" which is not reasonably necessary for support. See 11 U.S.C. § 1225(b)(2).

confirmation but before completion of their plan payments, the court allowed the motion of unsecured creditors to modify the debtors' plan to pay unsecured creditors in full.⁴ See Cook, 148 B.R. at 281. In the present case, however, no party sought modification of the debtors' plan during pendency of their case to provide for distribution of the debtors' property interest in the malpractice lawsuit. Since the debtors' discharge has been entered and their case closed, there is no longer any plan to modify and, thus, no means to provide for disposition of this property interest under the debtors' Chapter 12 plan.

Section 1227(b) provides with respect to property of a Chapter 12 estate that, unless otherwise provided in the debtor's plan or the order confirming plan, "the confirmation of a plan vests all of the property of the estate in the debtor." 11 U.S.C. § 1227(b). As indicated, the debtors' plan contained a similar provision for the vesting of estate property in the debtors and did not otherwise provide for disposition of the debtors' property interest in the lawsuit that was subsequently filed against attorney Bruegge. This property interest, then, vested in the debtors at confirmation and, following the debtors' discharge and the closing of the case, became property of the debtors free and clear of claims of unsecured creditors provided for by the plan. See 11 U.S.C. §§ 1227(c), 1228(c); 5 Collier on Bankruptcy, ¶ 1227.01, at 1227-3 to 1227-4 (15th ed. 1994).

⁴The Cook debtors' plan provided for a 10% dividend on claims of unsecured creditors.

The Court finds that there is no requirement in the debtors' Chapter 12 plan or the provisions of Chapter 12 that the proceeds of the debtors' lawsuit be distributed to unsecured creditors. Accordingly, the Court concludes that the \$4,000 in settlement proceeds should be distributed to debtor Priscilla Hennessey free and clear of the claims of prepetition creditors.

SEE WRITTEN ORDER.

ENTERED: SEPTEMBER 28, 1994

/s/ Kenneth J. Meyers_____
U.S. BANKRUPTCY JUDGE